United States Senate
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510–6350

February 28, 2003

The Honorable Don Nickles
Chairman
Committee on the Budget
United States Senate
Washington, DC 20510

The Honorable Kent Conrad
Ranking Member
Committee on the Budget
United States Senate
Washington, DC 20510

Dear Don and Kent:

As Chair of the Committee on Small Business and Entrepreneurship (Committee), I submit the following views and estimates on the President's Fiscal Year 2004 budget request for the Small Business Administration (SBA) and other matters under the Committee's jurisdiction, as directed by § 301(d) of the Congressional Budget Act.

The SBA has had additional functions imposed on it by statute; therefore the need for additional personnel and funding will be necessary to carry out those mandates. I bring to your attention the following key SBA program and service areas.

Investment Initiatives to Improve SBA's Operations and Service. The President's budget request includes $21 million to enable the SBA, through new investments in infrastructure, technology and human resources, to improve its operational efficiency and service to its small business customers. The initiatives follow an extensive review of the Agency's operations by the General Accounting Office (GAO) and are generally in agreement with the GAO's findings and recommendations.

In the late 1990s, the Committee received testimony and many press releases describing how the SBA would become a 21st Century agency. Following the pronouncements very little actually happened. It does appear that the SBA Administrator has put together a well-thought-out plan defining the future of the Agency, and we in Congress should give our approval of the initiatives contained in the FY 2004 budget request. For an agency the size of the SBA, it is seeking a substantial amount to undertake its workforce and operations transformation. While change of this magnitude is not without risk and can be unsettling to the SBA's workforce, the change is long overdue.

7(a) Guaranteed Business Loan Program. The small business community must have access to a strong 7(a) loan program to obtain long-term financing that would not otherwise be available. Last year, more than 50,000 small business concerns, who could not obtain comparable credit elsewhere, turned to the SBA's loan programs for critical financing. The budget request includes sufficient budget authority (BA) to fund 7(a) loans totaling $9.3 billion.

It is conservatively estimated that the program demand from small businesses will be at least $11 billion. An increase of $17 million in BA would be needed to fund the additional loan volume. Therefore, I strongly recommend that $17 million be added to the Business Loan Account of the SBA Fiscal Year 2004 budget to support an $11 billion 7(a) loan program. The net result of the Administration's budget would be to drive both the small business borrowers and the lenders from the program. I do not believe it is the intention of the Administration, nor is it the intent of the Congress, to deny needed business loans to small business borrowers at the same time the economy is slowing and credit underwriting standards have tightened significantly.

Subsidy Rates. The small business community is dependent on the SBA 7(a) program to obtain long-term financing at a competitive interest rate. Currently, both the borrowers and the lenders pay significant fees to the SBA to help offset the credit subsidy cost necessary to underwrite the program. During the past six years, the Committee studied closely the management of the credit subsidy rates for the credit programs at the SBA. For the past decade, the losses under the programs have declined dramatically; however, these program improvements have not been fully recognized by the Office of Management and Budget (OMB) and the SBA in calculating the credit subsidy rate.

In July 2001, the GAO delivered its report to the Committee. Significantly, the GAO revealed that since Fiscal Year 1992, defaults and recoveries for the 7(a) program were overestimated by the SBA and OMB. What the overestimates mean in real cost is that the Federal government collected significantly more money than needed to fund the loss reserve accounts as required under the Credit Reform Act of 1990. Specifically, the GAO found that the Federal government had collected over $950 million in excess fees paid by borrowers and lenders and by taxpayers' funds appropriated by the Congress. This amount has grown to over $1.1 billion with the information supplied in the President's Fiscal Year 2003 budget request.

In response to proposed legislation to direct the OMB to correct the credit-subsidy rate problem, the OMB and the SBA undertook a lengthy effort to develop a more accurate method for calculating the default and recovery rates for the 7(a) program. Their undertaking resulted in the development of an econometric model that can more accurately predict the likelihood of 7(a) loan defaults. The new model, when applied to the credit subsidy rate for FY 2003, lowered the subsidy rate from 1.76% to 1.04%. Legislation that I sponsored, S. 141, has recently passed the Senate and House of Representatives that would retroactively apply the new credit subsidy estimate beginning October 1, 2003. For the pending FY 2004 budget request, the credit subsidy rate estimate is 1.02%.

HUBZone (Historically Underutilized Business Zone) Program. This program was adopted in the Small Business Reauthorization Act of 1997 and authorized at $5 million for Fiscal Years 1998 through 2000. In the Small Business Reauthorization Act of 2000, the HUBZone program was reauthorized at $10 million for Fiscal Years 2001 through 2003. Actual appropriations for this program, however, have remained at $2 million each year for Fiscal Years 1998 through 2001. In 2002, an unexpected omission in the Commerce-Justice-State

Appropriations bill deleted the HUBZone program funding, although in the Defense/Supplemental Appropriations bill the Congress subsequently directed that HUBZone funding be restored through a reprogramming request. In 2003, the Conference Committee on the FY 2003 Omnibus Appropriations Act, once again, zeroed out program funding.

Although the Federal government has numerous economic development programs, the HUBZone program is a unique response to a particular problem. The HUBZone program provides incentives for the government to act as a customer to small businesses. While HUBZone firms stabilize their revenues and establish a non-governmental customer base, Federal contracts can keep these firms alive and keep the economic development effort from collapsing.

Consistent underfunding of the HUBZone program threatens the program's ability to deliver on these promises. In Fiscal Year 2003, Federal agencies are to award 3% of all prime contract dollars through the program, or approximately $6 billion in prime contracts. Moreover, § 8(d) of the Small Business Act requires large business concerns to submit HUBZone program subcontracting plans in contracts over $500,000 ($1 million for construction contracts). To date, the SBA has certified over 6,000 firms in the HUBZone program, a substantial improvement over last year. However, 6,000 firms are still insufficient to support this volume of contracting. Additional funding is necessary to seek out and certify a sufficient number of qualified firms, and particularly to identify firms that supply goods and services needed by Federal purchasing offices in different regions of the country. As HUBZone participation increases, the need for increased enforcement and oversight of program requirements will also increase correspondingly. Accordingly, the HUBZone appropriation for Fiscal Year 2004 should be increased, at a minimum, to the $5 million originally authorized in the HUBZone Act of 1997.

Federal and State Technology (FAST) Partnership Program. Technological innovation creates jobs, increases productivity and economic growth, and serves as a counter force to inflation and the nation's balance of payments deficit. The small business sector is the Nation's principal source of significant innovation; yet, it is large businesses, universities and government laboratories that historically have conducted the vast majority of Federally funded research and development (R&D).

Consequently, two decades ago, the Congress established a government-wide policy to encourage small business innovation by creating the Small Business Innovation Research (SBIR) program at the U.S. Small Business Administration (SBA). Ten years later the Congress created the Small Business Technology Transfer (STTR) program. Over the past four years (FY 1999, FY 2000, FY 2001 and FY 2002), $5.1 billion in R&D grants have been awarded to small businesses under the SBIR and STTR programs.

The Congress provided a significant boost to small businesses seeking to participate in the SBIR program when it created the Federal and State Technology Partnership (FAST) program. FAST is a competitive matching-grant program to encourage states to create an atmosphere conducive to the development of high-technology small businesses, including the establishment of coalitions of university and private-sector organizations. While the SBA administers the FAST program, each agency with an SBIR program participates in the determination of state programs that should be funded. The FAST program is intended to support the SBIR program, by marshaling more and higher quality research and development proposals to SBIR agencies.

The SBA was appropriated $3.0 million for the FAST program for Fiscal Year 2003, however, the Conference Committee on the FY 2003 Omnibus Appropriations Act has, without any consultation, deleted all funding. Fifty states, the District of Columbia and four territories are eligible for funds under the program. While funding under the FAST program is to be provided on a competitive basis and the program does not require that each state receive funds, if each state or jurisdiction submits an eligible proposal and receives funds, the average grant amount should be sufficient to provide an effective incentive to encourage high-technology small business development. Therefore, I request that the FAST program be funded at its authorized level of $10 million.

SBIR Technical Assistance (Rural Outreach Program). One critical component of the SBIR program, to help small companies in rural states seek SBIR awards, is the Rural Outreach Program (ROP). This program provides technical assistance grants to state programs and research centers to assist small companies in preparing SBIR and STTR submissions seeking research awards. Currently, 23 states, the District of Columbia, and Puerto Rico participate in the ROP.

In 2003, however, the SBIR ROP has fallen victim to the Conference Committee on the FY 2003 Omnibus Appropriations Act, which agreed to zero out all ROP funding. For Fiscal Year 2004, the Administration seeks to fund the ROP at $500,000. This amount would provide only $20,000 per state, which is insufficient for states to maintain even their current ROP efforts. ROP should be funded for Fiscal Year 2004 at its authorized level of $2 million.

Procurement Center Representatives (PCRs). PCRs work with Federal agencies to increase small business opportunities in the Federal acquisition process by reviewing their acquisition plans and making appropriate recommendations to set aside opportunities for small businesses. Like all Federal agencies whose workforce is nearing retirement age, the SBA faces a serious "brain-drain" of procurement knowledge as its staff of Procurement Center Representatives (PCRs) has shrunk below sustainable levels. Failure to hire and retain sufficient PCRs further diminishes the SBA's ability to carry out its statutory mandates as existing staff retires. More importantly, acquisition is a technical discipline that requires knowledge and experience to manage effectively; therefore, tasking these responsibilities to other SBA employees as a part-time function will not address insufficient staffing levels.

Further, recent legislation is tasking PCRs with even more responsibilities making it impossible for them to address the Federal government's chronic failure to achieve the 23%

minimum annual threshold established by the Congress in 1997. Many of the existing staff have no funding to travel to the contracting activities nominally assigned to them, so the SBA's ability to monitor and strengthen small business contracting is even less than it appears on its face. Without sufficient PCRs, the SBA will be unable to work with contracting activities to develop small business-friendly procurement strategies, and will be forced to intervene at the last minute (for example) to appeal proposed bundling of contracts. This will result in delays in contracting by other agencies, frustrating their efforts to carry out their own responsibilities.

The SBA has stated that it "plans to improve oversight by conducting surveillance reviews of Federal agencies and prime contractors." I am We are concerned, however, that without additional resources, the SBA will be unable to conduct these reviews to identify potential areas for improvement and its position to promote small business participation in Federal procurement will be seriously weakened.

Accordingly, the budget should include funding to hire and train an additional 20 PCRs in Fiscal Year 2004, while replacing attrition among existing PCRs. Based on costs to hire PCRs in the past, this will require an additional $2 million for the SBA Office of Government Contracting. Reports accompanying the budget resolution should clearly state the purpose for which this funding is provided, to ensure it is allocated to its intended purpose.

Office of the National Ombudsman. Once again the budget request proposes to under-fund and undermine the importance of this program by requesting the same flat-line amount of $500,000, which has served as a virtual placeholder for this line-item.

The Regulatory Fairness program, administered by the Ombudsman, was created under the Small Business Regulatory Enforcement Fairness Act (SBREFA) that passed the Senate without opposition in 1996 (Public Law 104-121). The SBA Office of the National Ombudsman is charged with overseeing the ten Regional Regulatory Fairness Boards that convene throughout the United States to listen to small businesses describe their experiences with Federal regulatory agencies.

This program, therefore, provides a critical link between small businesses and Federal agencies. In Fiscal Years 2001 and 2002, this program was appropriated only $500,000, making it very difficult to conduct the necessary follow-up to ensure that agencies are responding to the concerns raised through the reports submitted by the Fairness Boards. This is not about small businesses trying to avoid their responsibilities; it is about providing a sounding board so that the Administration and the Congress can find out what is actually happening across the country.

At a minimum, this allocation should be increased to $1.625 million. This will permit more meetings of the Regulatory Fairness Boards to be held and more staff to be hired. With ten Regional Regulatory Fairness Boards throughout the country, at approximately $10,000 per meeting, the previous allocation only allowed one meeting of each board per year. This should be increased to at least four meetings per board per year, which will require an increase of approximately $300,000. Ideally, at least one meeting of a board should occur in each state each year. Further, increased staff support will allow for greater specialization and thus better follow-up with the agencies.

Finally, this greater allocation will permit more promotion of the program and greater use of technology by designing better on-line filing options for small businesses to file their complaints.

Small Business Development Center (SBDC) Program. The SBDC program is the SBA's largest management and technical assistance program. The SBDCs serve more small businesses and individual entrepreneurs than all other SBA programs, credit and non-credit, combined. It is projected that in FY 2003, the SBDC program will provide counseling and training assistance to over 650,000 persons and small businesses. Significantly in FY 2001, the SBA has reported that the SBDC program helped to create or retain over 132,000 jobs.

The budget request of $88 million is $1 million more than was appropriated for Fiscal Year 2003. This amount, while significant, fails to address the changes that have occurred in recent years. As the result of the 2000 Census, twenty-four state SBDC programs have taken cuts in SBA funding for Fiscal Year 2002. These twenty-four states took cuts, not because they lost population, but because their population did not grow as fast as the national average during the 1990s. Consequently, I recommend that the SBDC funding for FY 2004 be increased to $105 million so that SBDC services will not be curtailed in states that are experiencing decreases in funding from the SBA.

Thank you for the opportunity to comment on programs within the Committee's jurisdiction. I look forward to working with you to develop a budget resolution that is cognizant of both the Administration's reform agenda and of the need for a strong small business program. If you have questions about this letter, please contact me directly or have your staff contact Mark Warren, my Staff Director on the Committee, at (202) 224-5175.

Sincerely,

Olympia J. Snowe
Chair